

ANALYSIS OF ORIGINAL BILL

Franchise Tax Board

Author: Strickland Analyst: Roger Lackey Bill Number: AB 2640
Related Bills: See Legislative History Telephone: 845-3627 Introduced Date: 02-22-2002
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Net Operating Loss Sustained By Nurseries From Pierce's Disease/Allows Deduction Carryover Until Loss Is Used

SUMMARY

This bill would allow special net operating loss (NOL) treatment for losses incurred by a nursery business as a result of Pierce's disease.

PURPOSE OF THE BILL

It appears the purpose of the bill is to provide tax relief to nurseries suffering economic losses as a result of Pierce's disease.

EFFECTIVE/OPERATIVE DATE

This bill is a tax levy and would become effective immediately upon enactment, and would apply to taxable years beginning on or after January 1, 2002.

POSITION

Pending.

ANALYSIS

FEDERAL/STATE LAW

A taxpayer may incur a loss in the operation of a business. Generally, a loss is incurred when the cost of selling merchandise or services exceeds the income generated by providing that merchandise or service. For tax purposes, there are several types of losses, including ordinary losses and capital losses. These losses are deducted against the taxpayer's income to reduce income, but only to zero. Any remaining losses that would reduce income below zero may be used to calculate a taxpayer's NOL.

An NOL is the excess of allowable deductions (as specifically modified) over gross income. Once calculated, federal law allows the taxpayer to apply the NOL against income from previous and future taxable years. **Federal law** provides, in general, that an NOL may be carried back two taxable years and forward 20 taxable years.

Board Position:

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<input type="checkbox"/> N	<input type="checkbox"/> OUA	<input checked="" type="checkbox"/> PENDING

Department Director

Date

Alan Hunter for GHG

04/12/02

Existing state law conforms to the federal computation of an NOL. However, California only allows a percentage of the federal NOL and does not allow NOLs to be carried back to previous taxable years.

For most taxpayers, the California NOL may be carried forward for 10 years as follows:

- For taxable years beginning on or after January 1, 2000, and before January 1, 2002, 55% of the NOL may be carried forward.
- For taxable years beginning on or after January 1, 2002, and before January 1, 2004, 60% of the NOL may be carried forward.
- For taxable years beginning on or after January 1, 2004, 65% of the NOL may be carried forward.

Existing state law allows special NOL treatment for losses sustained by a person conducting a farming business that is directly affected by Pierce's disease and its vectors. Specifically, the percentage of any NOL eligible for carryover is increased to 100% of an NOL sustained by a taxpayer conducting a farming business that is attributable to farming business activities in an area affected by Pierce's disease and its vectors. The special NOL can be carried over and offset against future income from the farm operation in the affected area. The special farming loss NOL can be carried over to each of the nine following taxable years until exhausted, which is the same period allowed for a general NOL.

State law requires the taxpayer to choose the special NOL treatment or a general NOL. If the taxpayer chooses the special NOL, the remainder of the taxpayer's NOL that is not attributable to farming activities conducted in the pest infestation area for the year sustained is forfeited.

THIS BILL

This bill would expand the special NOL treatment for losses due to Pierce's disease and its vectors sustained by a taxpayer conducting a farming business to also apply to a taxpayer conducting a nursery business. The special NOL would apply to losses attributable to taxable years beginning on or after January 1, 2002, and before January 1, 2003.

IMPLEMENTATION CONSIDERATIONS

It's not clear what constitutes a "nursery business." Without a clear definition taxpayers and the department would not be able to properly identify whether a taxpayer is qualified for or should be allowed the special NOL. The term would need to be defined for the department to properly implement this bill.

LEGISLATIVE HISTORY

AB 238 (Pacheco, Ch. 623; Stats 2001) allows special NOL treatment for losses sustained by a person conducting a farming business that is directly affected by Pierce's disease.

OTHER STATES' INFORMATION

The laws of *Florida (corporate taxpayers only), Illinois, Massachusetts, Michigan, and Minnesota* were reviewed because of similarities in the tax laws of those states to California's income tax laws.

Each of these states allows 100% of NOLs to be carried over. Consequently, the special NOL treatment proposed by this bill is already law for all NOLs in these states.

FISCAL IMPACT

This bill would not significantly impact the department's costs.

ECONOMIC IMPACT

Revenue Estimate

This bill would only apply to losses attributable to taxable years beginning on or after January 1, 2002, and before January 1, 2003. The revenue loss for this bill is estimated to be very minor—less than \$100,000 for 2002-3.

According to industry experts, the statewide gross dollar amount of lost sales by nurseries that are due to Pierce's disease is projected to be within the \$3-\$5 million range. However, in most cases, the lost sales do not result in net operating losses.

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